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C O N F I D E N T I A L SECTION 01 OF 02 ANKARA 001131

SIPDIS

STATE FOR E, P, EUR AND EB
TREASURY FOR U/S TAYLOR

E.O. 12958: DECL: 09/02/2006
TAGS: ECON PREL TU
SUBJECT: TURKEY'S ECONOMY: BUDGET IMPASSE WITH IMF

Classified by Econon Counselor Scot Marciel for reasons 1.5 (b,d).

¶1. (C) Summary: Market analysts predict the market's current positive sentiment will reverse quickly by Monday, in the absence of news of a deal on U.S. troop deployments. Meanwhile, the GOT has reached an impasse with the IMF staff over the 2003 primary budget surplus - the IMF staff see a $3.4 billion shortfall towards the 6.5 percent of GNP target. The GOT is not offering to undertake any new fiscal measures in their talks with the IMF, per resrep. One senior MinFinance contact told us he is concerned that the GOT will submit the budget to the parliament without IMF approval. Deputy PM Sener's surprise announcement February 19 of a new draft bill - to guarantee government jobs to all workers in privatized enterprises - sparked another IMF protest letter. End Summary.

## Markets Positive for Now

¶2. (U) On February 20 Turkish financial markets remained positive, believing in a scenario of several more days of tough bargaining between the U.S. and Turkey before the two sides strike a deal on a U.S. troop deployment. However, market analysts such as Cem Akyurek, chief economist for Global Securities (Turkey's largest stock brokerage) tell us markets expect positive news by Monday.

-- The lira depreciated slightly to TL 1,633,000 to the dollar (from TL 1,626,000); T-bills were stable at 56.5 percent compounded; the Istanbul Stock Exchange closed up 0.5 percent in continued heaving trading.

## 2003 Budget Impasse

¶3. (SBU) Both Ministry of Finance and IMF staff sources tell us the two sides have reached an impasse on the primary surplus target: the GOT believes their draft 2003 budget exceeds 6.5 percent of GNP; while IMF staff calculate the measures in the draft budget which are acceptable to them as yielding only about 4.8 percent of GNP. This 1.67 percent of GNP difference amounts to TL 5.9 quadrillion or $3.4 billion. Ahmet Kesik, MinFinance Deputy DG for the budget, told us the gap could largely be closed if IMF accepted two GOT positions.

-- First, the GOT has proposed postponing the 2003 "Direct Income Support" payments for poor farmers into 2004 (nearly $1 billion). IMF staff, bolstered by the World Bank, cannot accept what they see as reversing a key agricultural reform, while the GOT engages in new agricultural spending under the price support system (e.g., on hazelnuts and tobacco).

-- Second, the GOT wants to exclude from the definition of primary surplus "foreign in-kind contributions" (amounting to $1.5 billion, these are goods - including military equipment - imported by the line ministries using long-term foreign export agency credits rather than cash). IMF staff want these purchases included as primary spending (and in fact Kesik agrees that this would be an effective way of limiting ministries' ability to import such goods).

-- IMF staff see the $3.4 billion primary surplus gap as largely related to their more realistic assessment of the GOT's fiscal measures. For instance, the GOT claims its tax amnesty will result in TL 2.4 quadrillion ($1.4 billion) in revenue, based on a 75 percent participation rate by delinquent taxpayers. But IMF experience indicates a much lower participation rate, resulting in likely revenue closer

to TL 0.7 quad ($400 million). IMF staff have asked MinState Babacan and MinFinance Unakitan to adopt more of the fiscal measures proposed by IMF staff in order to close the gap, which they have refused to do.

¶4. (C) Kesik, the GOT's main budget expenditure expert, told us in confidence he is concerned that the GOT may decide to submit the 2003 budget to the parliament without IMF approval. Kesik said his contacts with Finance Minister Unakitan "scare" him. "These guys just don't understand the issues." (Note: Kesik is a strictly observant Muslim from the AK stronghold of Konya. Unlike some other senior bureaucrats, he has no ideological problems with AK. His problem is he thinks they're incompetent.) MinFinance Unakitan told the press late February 20 that the GOT would send the 2003 budget to the parliament "shortly, probably next week."

¶5. (SBU) Budget Note: One of Kesik's constant themes is the need for social security reform. In the late 1980's, when he started at the Finance Ministry, the state's social security funds were self-financing. Now the central government budget includes an annual appropriation of TL 16 quadrillion (nearly $10 billion) to keep these pension funds solvent. The chief villain, per Kesik, is former President Demirel, who lowered the civil service retirement age to 39. This was the first step in bankrupting the social security system in Turkey, per Kesik. End Note.

## A Negative Surprise On Privatization

¶6. (SBU) Following the February 19 Cabinet meeting, Deputy PM Sener announced that the GOT had agreed to submit to parliament a "privatization job law." The law would guarantee continued public sector employment for state enterprise workers who lose their jobs through privatization. The daily Milliyet estimates that the law could establish as many as 70,000 new civil service positions (there are currently 62,000 unionized workers and 10,000 civil servants in the SEEs scheduled for privatization). Sener said the following:

-- "In a country with a serious unemployment problem like Turkey, a privatization program that ignores the need to provide jobs to those who lose them through privatization is unacceptable."

-- "The core of the new law provides that workers who are likely to lose their jobs can apply for a new civil servant position within three months, and can continue to work for the government."

¶7. (SBU) IMF resrep told us February 20 that IMF mission chief sent a written note to Treasury U/S Oztrak that the new law, which came as a surprise to the IMF mission, was "unacceptable."

¶8. (SBU) Comment: Sener has a point about the unemployment problems of privatization. The solution is to work with the World Bank, which has offered the GOT loan programs to support severance payments and job retraining for privatized SEE workers. Instead, Privatization Administration officials have complained to us that the World Bank's conditions make these loan programs unworkable. Now the GOT is taking the counter-productive path of keeping everyone in the public sector, reducing much of the potential efficiency gains of privatization.
PEARSON